THE RIGHT STOCK AT THE RIGHT TIME

Prospering in the Coming Good Years

LARRY WILLIAMS

WILEY

JOHN WILEY & SONS, INC.

THE RIGHT STOCK AT THE RIGHT TIME

THE RIGHT STOCK AT THE RIGHT TIME

Prospering in the Coming Good Years

LARRY
WILLIAMS

WILEY

JOHN WILEY & SONS, INC.

Published by John Wiley & Sons, Inc., Hoboken, New Jersey.
Published simultaneously in Canada.

For general information on our other products and services, or technical support, please contact our Customer Care Department within the United States at 800-762-2974, outside the United States at 317-572-3993 or fax 317-572-4002.

Wiley also publishes its books in a variety of electronic formats. Some content that appears in print may not be available in electronic books.

For more information about Wiley products, visit our web site at www.wiley.com.

ISBN: 0-471-43051-X

Printed in the United States of America.

10 9 8 7 6 5 4 3 2 1

ACKNOWLEDGMENTS

This book would never been possible without books and research that went before. I want to specifically thank Yale Hirsch, of the *Stock Traders Almanac*, and Steve Moore and Nick Colley of Moore Research.

The high-yield strategy could not have been accomplished without the efforts of Bill Aronin, Joe Getts, and Lisa Liang at Qualitative Analytics. Without my able assistant, Jennifer Wells, this book, and all my other work, would never get done. Nor would this book have seen the light of day without the support and attention of Pamela Van Geissen. Tom DeMark was a great sounding board for many of the ideas and my best cheerleader. Finally, a personal note of thanks to Harvey Levine, who kept me running in more ways than he knows, and Louis Stapelton for the title idea.

We are all indebted for the assistance these wonderful people, especially Carla, provided in helping me present my vision of what will happen in the next few years.

And finally I would like to point out what my best five investments have been: my children, Kelley, Jason, Sara, Michelle, and Paige. Thanks, gang, for many years of the best returns of my life.

CONTENTS

PREFACE

This story begins in 1962, the year I first began studying stock market prices. I had no knowledge of why the stock market crashed that year, other than what was released in the newspapers: President Kennedy had attacked the steel industry, prohibiting any increase in steel prices. That bit of bad business news knocked the stock market down hundreds of points. The newspapers, then as now, were filled with horror stories of people losing money, and of how bad the economy was. Many cried that this was the beginning of another 1929-like era.

In hindsight, however, it was not a time to sell stocks; it was a time to buy stocks. October 1962 began a huge up move that would not culminate in a top until February 1966 when the Dow Jones Industrial Average surpassed 1,000 for the first time in history—what some felt was an "astronomical level." Frankly, it's hard to recall anything that long ago, but the one thing I do remember is that nobody in the fall of 1962 was advising people to buy stocks or to take any kind of shot at the market. In retrospect that's what everyone should have done. What was present was one of the greatest buying opportunities that I've been fortunate enough to have lived through.

Ten years later, 1972, saw a similar situation. Stock prices had been low, the economy was bad, and things looked bleak. Then lo and behold on one bright day the stock market, as measured by the Dow Jones Industrial Average, began to rally. As is usually the case, the savants and sages of Wall Street did not herald in this buy point. However, 1972 was not quite like 1962, a point that needs to be fixed in every investor's mind. Seldom is one rally or year exactly like the prior period. Although there was a tremendous rally in the fall of 1972, it quickly gave way to a decline in 1973 and 1974 before the next substantial bull market began.

My search for stock market truth, which began in 1962, included an interesting selection of books, among them *Tides in the Affairs of Men* by Anthony Gaubis and Edgar Lawrence Smith (Macmillan, 1939). These authors' central point was that there is a 10-year pattern in the U.S. stock market and economy. The thrust of their argument was that most stock market highs come in the latter part of every decade. By that they meant that one was more likely to find stock market highs in years ending in six and nine, such as 1966 and 1929. Gaubis and Smith looked at the cycle going back into the earlier part of the 1900s and presented their case in the book.

As a young man I simply had no perspective, as well as very little confidence that this long-range pattern (or cycle) really worked. I wondered if it would hold in the future. I did not know this then, but I sure do now. While certainly the 10-year pattern has not precisely called all major market highs and lows, it has done a very, very good job of pointing investors to the most probable, logical, and best times for the stock market to rally or decline.

The ensuing years have given me much to think about as I have studied the markets and economic cycles. As an example, the stock market debacles we saw in the latter part of the twentieth century occurred in synch with what Gaubis and Smith wrote; stocks got slammed in 1987, as well as 1989. And of course, the one no one will ever forget: 1999 was the top for the Nasdaq's high-flying stocks and the beginning of a 76 percent correction in high-tech issues.—a correction that wiped out many individual investors, professionals, and mutual funds.

Was it possible that the decennial pattern identified, at least in part, the economic up-and-down swings from 1962 forward? It is an interesting question, one I will address in this book and one I think, after you see the data, you will agree presents a superb buying opportunity for 2002 and 2005. I am deeply indebted to Gaubis and Smith for starting my journey on the path of looking for stock market cycles. Unlike many students of market cycles, though, quite frankly I don't place much value on most of them. For sure, I do not think they are precise. Most market cycles, such as the 18-day cycle, 200-day cycle, and all that, are at best difficult to trade or use to invest. Yet there are several very dominant cycles that seem to hold water, and more importantly, hold up in the future. That's what much of this book is about.

Additionally, I'd like to share with you some methods, ideas, and techniques of investing I have discovered and found to be successful for the average investor. These are easy to use and easy to follow. They can and do get to the heart and truth of the markets. It does not matter what a company does in terms of its product or service nearly as much as whether the company is profitable and what its growth prospects are.

That was a problem with the roaring bull market of high-tech stocks: Fundamentally they were not sound, so while stories carried them to some amazing price levels, they couldn't maintain those levels. That they would crash was inevitable.

What I hope to show you is that fundamentals have moved stocks in the past and will move stocks in the future, regardless of what the company does. Ultimately, it always gets down the fundamentals; it always gets down to value. As the great baseball manager Tommy Lasorda said, "God may delay but God does not deny." In this business of speculating, value in the form of growth and profitability may indeed be overlooked for a while, but ultimately it prevails.

In 1982, I wrote a book called *How to Prosper in the Coming Good Years*. It was a refutation of the negativity the purveyors of pessimism had spread across the country at that time. I took an outrageously bullish posture on the future for two reasons. First, Ronald Reagan and supply-side economics were coming on the scene. My study of the past showed that every time we had such incentive-based economic programs and incentive-oriented economic systems, the markets always went higher.

On top of this was one simple fact that had been hanging in the cobwebs of my mind since 1962: Years ending in two usually produced the start of bull markets . . . years ending in twos usually produced overall economic up terms. So this book is very much a continuation of that 1982 book. The greatness of our economic system lies in front of us, not behind us. It is not all over; the good times are coming now as they will continue in the future. This book aims to help you pinpoint when those times are most apt to occur.

I would like to personally welcome you into my world of speculation, into the art of divining the future, into the art of living not in the past but in the tomorrows in today's be-here-now world.

LARRY WILLIAMS

Rancho Santa Fe, California
February 2003

THE RIGHT STOCK AT THE RIGHT TIME

1

THE 10-YEAR PATTERN IN THE UNITED STATES STOCK MARKET

"It's about time."
—My U.S. senatorial campaign slogan, 1978

What did the fall 2002 buying opportunity really mean? Are more fortune-making buy points coming in 2005, 2006, 2007, and 2008?

In this book I will go into detail explaining what I think will be the best buy points over the next 10 years. That's quite a claim. Can it be done, and if so how?

I'd like to first catch your attention with this: If one were to look for the best buying points of the twentieth century one could not help but notice that these stellar opportunities came in 1903, 1912, 1913, and 1920 into 1923. The ultimate best buy point came in 1932. This was followed by wonderful buy points in 1942, 1952, and 1962; 1972 wasn't bad (though 1973 was better), and, of course, 1982 was perhaps the second best buy point of the twentieth century. That was followed by another superb buy point in 1992. Notice that for the past 100 years, these ideal buying points came in years ending with a two or a three.

If you had invested in just these years you would have substantially outperformed the investor who chose to continually buy stocks. I find this rather amazing and, better yet, to be hard evidence that indeed there's something going on in the U.S. stock market—something that shows us when the best buying opportunities tend to occur. They are usually to be found in the first part of the decade—namely, years ending in twos and threes.

Figures 1.1 through 1.6 are of historic stock market activity and are well worth your study. The first, the Axe-Houghton index of stock market averages from 1854 until 1935, is from my personal files. The next group of figures, from Moore Research Centers, Inc., shows price activity for the 101 years from 1900 to 2001.

THE PAST IS THE FUTURE

The 1800s were no different from the 1900s; they presented a very similar scenario. Stocks roared in 1862 and 1872; 1883 was very close to a wonderful buy point, which came in early 1884. Along came 1893, which presented another good buying opportunity. I do not mean to imply that all one has to do as an investor is buy stocks every 10 years. I wish it were that easy! But it certainly helps to have a concept and time zone of when one wants to make a major play in the stock market. My concept of this is that years ending in twos and threes are most likely to turn out to be gargantuan buying points. It is almost as simple as that.

THE ROAD MAP TO MARKET SUCCESS

As a very young man, I followed the work of Edson Gould, who published an advisory service called "Finding and Forecasts." How I wish I had paid more attention to what Edson had to say. While it is true he had many arcane forms of forecasting, he consistently relied on the action of the Federal Reserve Board and what he called the 10-year pattern for stock prices.

Although I did not know it at the time, I'd been handed, figuratively speaking, the keys to the kingdom of stock market forecasting. The irony of the situation is that I spent the next seven years trying to determine how to forecast stock market prices out into the future. I studied the works of W. D. Gann as well as those of R. N. Elliott, several leading astrologers, and so on, which all turned out to be a waste of time. I was fortunate enough to eventually meet Gann's son, who was a broker in New York City and who explained to me that his father was simply a chartist. He asked why, if his dad was good as everyone said, the son was still "smiling and dialing," calling up customers to trade." It seemed he was somewhat disturbed by his father's

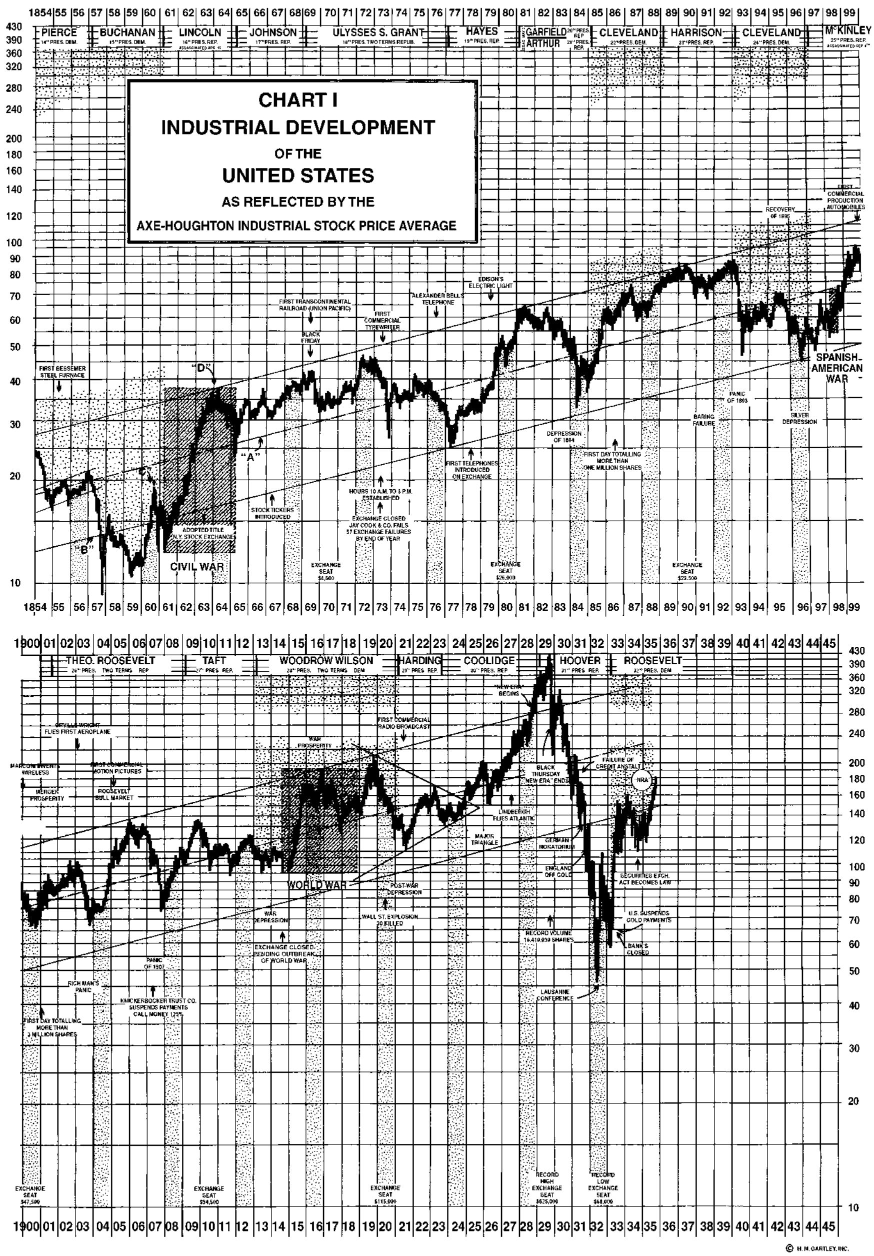

Figure 1.1 Market Averages from 1854 to 1935

Source: Axe-Houghton.

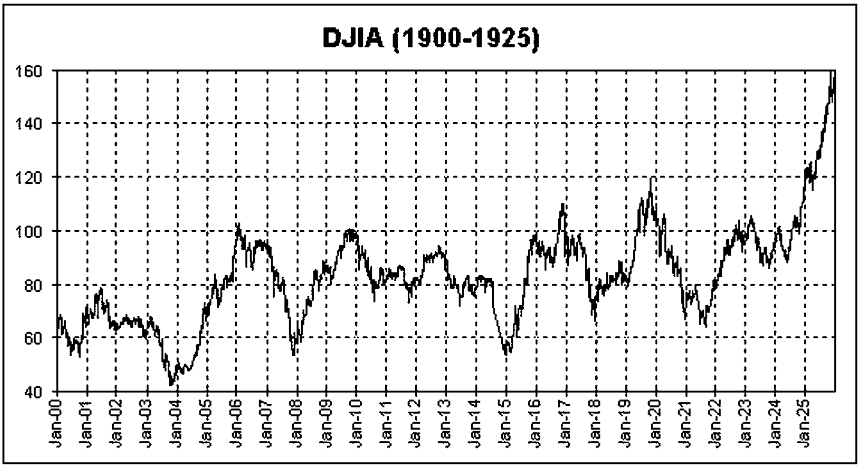

Figure 1.2 Dow Jones Industrial Average, 1900–1925
Source: Moore Research Center, Inc.

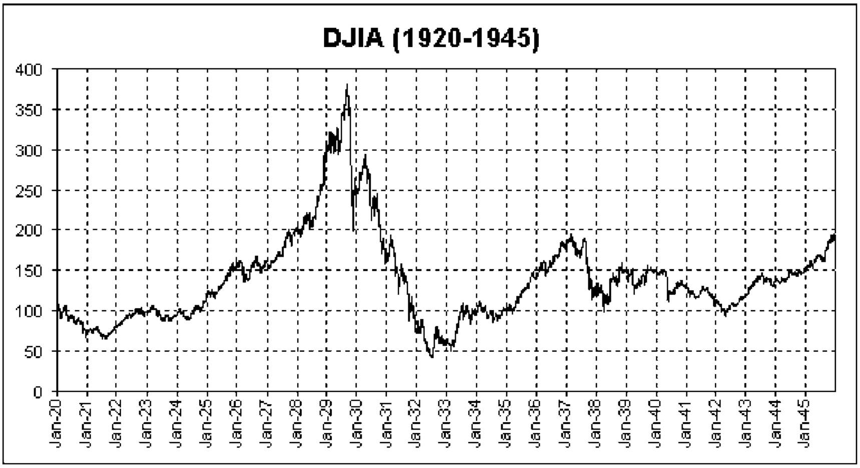

Figure 1.3 Dow Jones Industrial Average, 1920–1945
Source: Moore Research Center, Inc.

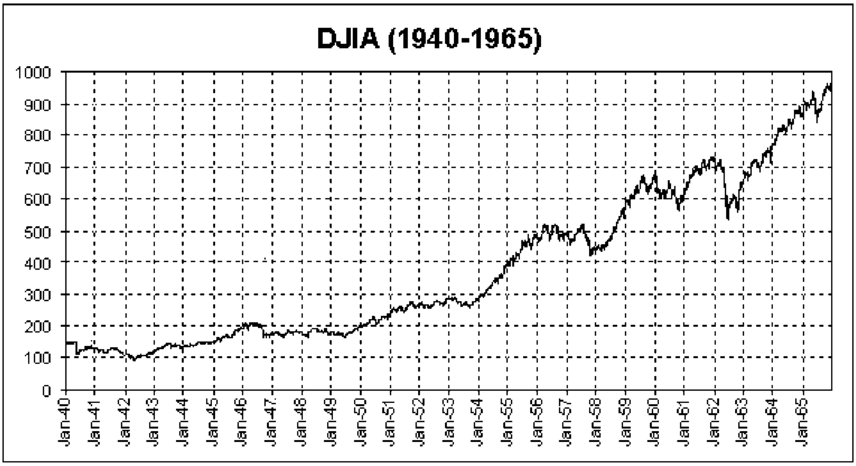

Figure 1.4 Dow Jones Industrial Average, 1940–1965
Source: Moore Research Center, Inc.

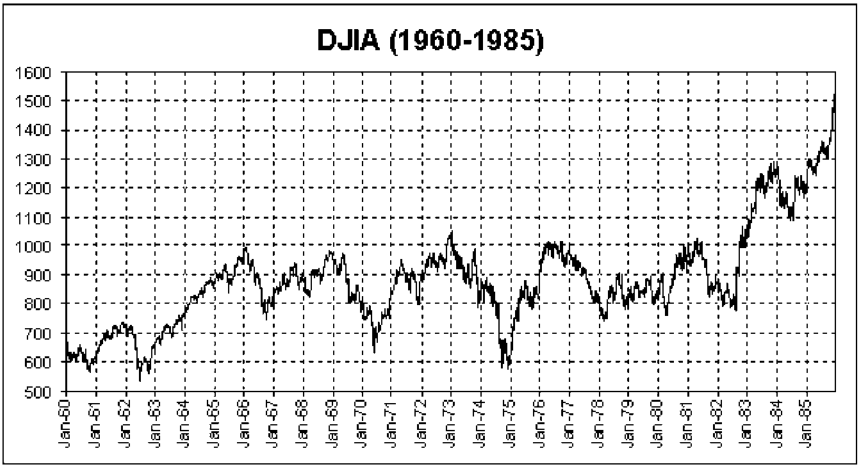

Figure 1.5 Dow Jones Industrial Average, 1960–1985
Source: Moore Research Center, Inc.

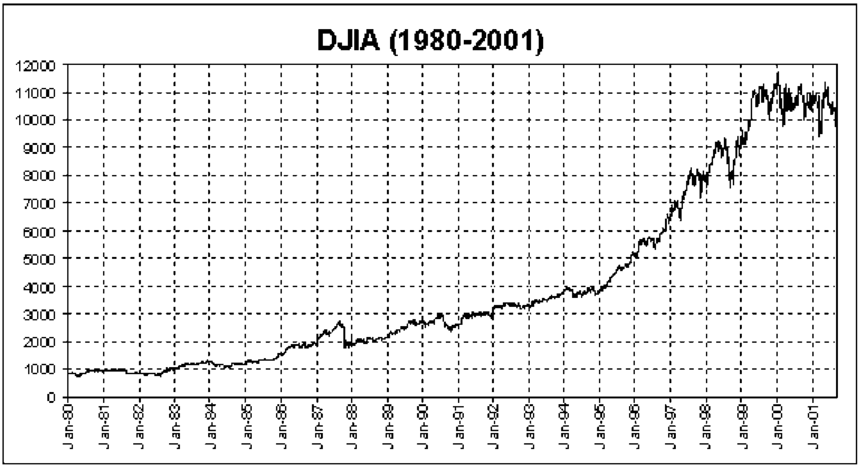

Figure 1.6 Dow Jones Industrial Average, 1980–2001
Source: Moore Research Center, Inc.

press-agentry, as it had led many people to come to him seeking the holy grail. If there was one, it was never passed on to the son.

At that same time I also met F. B. Thatcher, who had been Gann's promoter and advance man. He assured me in correspondence over the last five years of his life that in fact Gann was just a good promoter, not necessarily a good stock trader. F.B. made his own predictions, and they were not bad, but certainly not great.

He did give me his version of the genesis of the legend of Gann as a great forecaster. It all began, he told me, with an article in the *Ticker and Investment Digest* that has been reprinted many times since, where it was reported that Gann sold wheat at the high tick, or price, of the day. Thatcher said they simply hired a good press agent to place the story in a magazine for them. The magazine article placement was accomplished over a dinner where there was some pretty serious drinking as well some money sliding under the table, along with payment for a large ad in the magazine.

I did not know any of this at the time I began my search for something to predict the future. Like everyone else, I believed what I had read about all the great predictors. I wish now I had just stayed with the forecasting techniques that Gould devised. His techniques have been not only more accurate than Gann's but also a heck of a lot simpler to follow.

Figure 1.7 is just as presented by Gould as well as shown in Yale

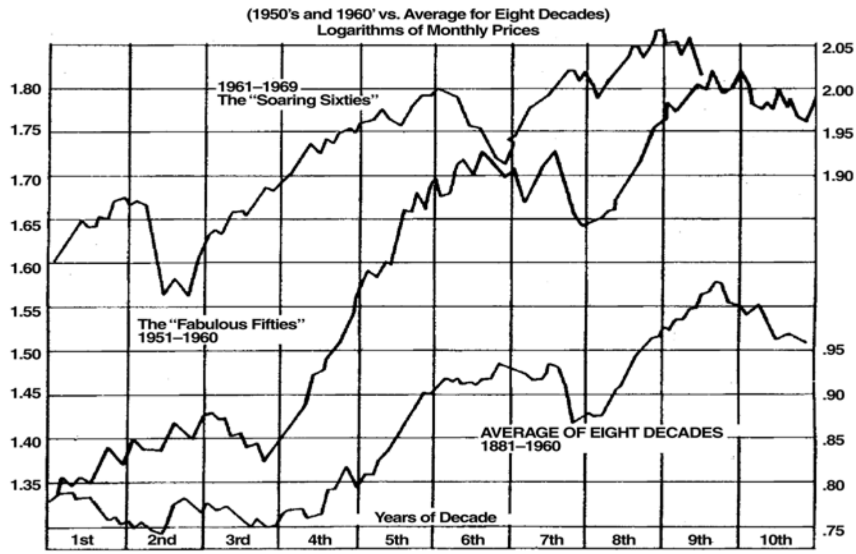

Figure 1.7 Ten-Year Patterns of Industrial Stock Prices

Sources: 1881–1917, Cowles Commission Industrials; 1918–1969, Standard & Poors's 425 Industrial Stock Price Index.

Reprinted from Yale Hirsch, *Don't Sell Stocks on Monday*.

Hirsch's book, *Don't Sell Stocks on Monday* (Facts on File Publications, 1986). The bottom line of the chart traces the average of eight decades of market history from 1881 to 1960.

Gould had taken the time to average, by hand, stock prices from 1881 through 1960 on a monthly basis. In this day and age, we can do that in almost the blink of an eye with a computer. I'm certain it took Gould a good year of work. Essentially, what he did was to average every month from 1881 forward through 1960. By this I mean he compared all January price movements in those 80 years to all other Januarys. This created a pattern that Gould used as a general road map that he expected the stock market to follow. What is fascinating is that while his work was completed in 1960, the roaring bull market of the 1960s fit the pattern almost to a T. Then along came the sluggish 1970s, and again the markets moved pretty much in accordance with the road map. The 1980s seemed to an almost uncanny extent to follow the road map Gould had charted out for us, with the crash of 1987 coming exactly where Gould's forecasts said it would occur. The tremendous buying point of late 1987 and early 1988 also was represented on the chart he made in 1960. I find that most remarkable.

Even more startling is that the end of the Nasdaq run-up in the waning weeks of the twentieth century also came in the tenth year of the decade, where Gould postulated market tops are most likely to be found.

The chart shown here reflects Gould's work using the Cowles Commission Industrials from 1881 to 1917; that stock market index was then blended into the Standard & Poor's index from 1918 to 1969. As you can see, his work suggests that the first year of a decade, such as 1981, 1991, and 2001, presents investors with choppy to down markets. Sometimes markets take off in years ended in two, such as 1982 or 1932; and for sure by the time the third year rolls around, such as 1983 or 1993, a bull market begins. I would suggest you place this road map of prices in your safe-deposit box to give your children instead of an inheritance. It has more value, and I don't think the value will deflate over the coming inflationary time periods.

Figure 1.8, thanks to Moore Research, shows what we call "out-of-sample" data. This means the chart reflects information not in the original time under study. In short, an idea or conclusion is reached from observing one time period; then the thesis is applied to data from another time, either before or after the test or discovery period. Seldom does the idea work on the out-of-sample information, by the way.

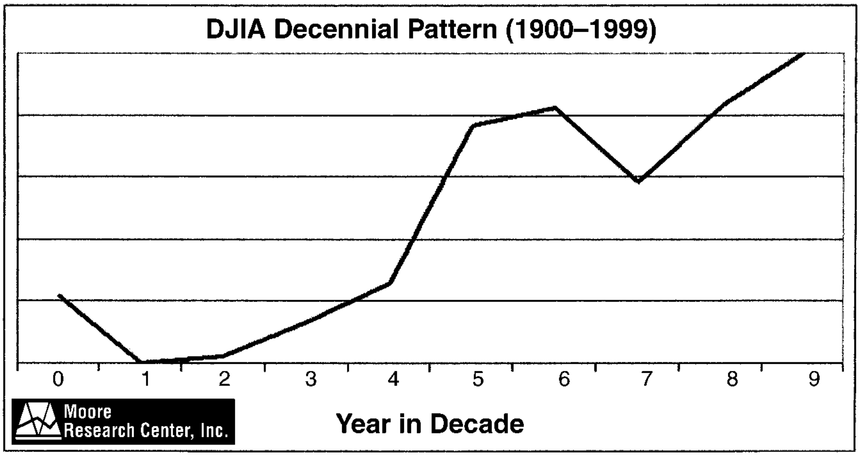

Figure 1.8 Dow Jones Industrial Average Decennial Pattern, 1900–1999
Source: Moore Research Center, Inc.